Factsheet 31 December2021

NIKKO AM INCOME STRATEGY

Applies to: Nikko AM Income Fund (retail).

Market Overview

- Third quarter GDP came in at -3.7% versus expectations of -4.1%, the fall reflecting impact of the recent Auckland lockdown. Pre-pandemic this would a been considered a monster of a GDP fall, but lessons from past lockdowns suggest that economic activity will pick up where it left off as lockdown restrictions are lifted.
- Continued Official Cash Rate (OCR) increases expected, however with a risk being the OCR peaks at a lower level than many assume and possibly take longer than expected to get there.

Fund Highlights

- The fund is holding close to the upper permitted limit of shares as we continue to believe shares have a good chance of outperforming bonds over the next three years.
- In addition to shares providing a steady stream of dividend income, we expect the industry sectors and business models of the companies we invest in should be rewarded by a steady or rising share price.

Distributions

- The defined distribution rate (which is used to calculate the distribution you receive from the fund) is set at the start of each calendar year, based on the price of the fund at that point.
- The defined distribution rate for 2022 is 3.5% p.a. This income will be distributed in four equal amounts each calendar quarter, based on the price as at 1 January 2022. The defined distrubiton rate for 2021 was 3%.

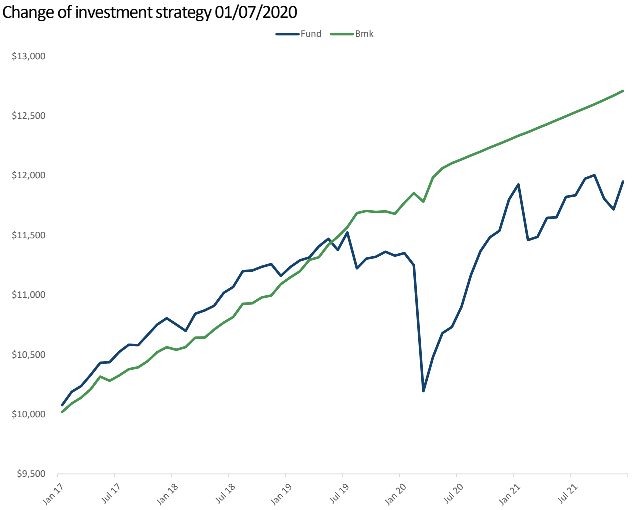
Performance

	One month	Three months	One year	Three years (p.a)	Five years (p.a)	Ten years (p.a)
Retail[1]	2.00%	-0.45%	1.28%	2.31%	3.63%	4.87%
Benchmark[2]	0.31%	0.89%	3.33%	4.65%	4.91%	6.83%
Market Index[3]	1.07%	-1.41%	-2.17%			

1. Returns are before tax and after the deduction of fees and expenses and including tax credits (if any).
2. Current benchmark: RBNZ Official Cash Rate +3.00% p.a.
3. Current appropriate market index: 62.5% Bloomberg NZBond Credit 0+ Yr Index, 30% S&P/NZX 50 Gross Index, 7.5% Alternatives exempt.

Five Year Cumulative Performance, $10,000 invested[1,2]

Change of investment strategy 01/07/2020



Portfolio Manager

Fergus McDonald,

Head of Bonds and Currency

Fergus is responsible for the investment of the Bond, Cash and Currency mandates. Fergus has been actively involved in the NZ financial markets since 1981. The portfolio management team for the domestic fixed income funds includes Ian Bellew, Fixed Income Manager and Matthew Johnson, Fixed Income Manager.

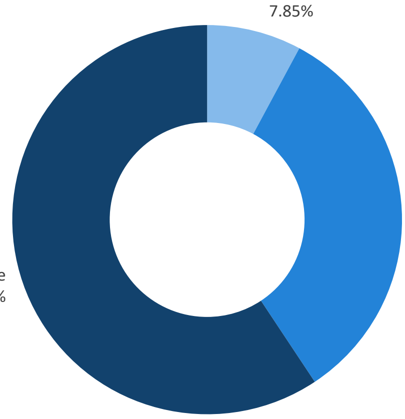
Overview

The strategy aims to provide investors with regular income from an actively managed investment portfolio. The fund invests in NZ fixed interest, Australasian equities and property. Equities with a good dividend stream and a focus on growing value over time are selected as an attractive alternative to fixed income securities. Equity selection is determined by the NZ investment team.

Objective

The objective of this fund is to outperform the RBNZ Official Cash Rate by 3.00% p.a. over a rolling three-year period before fees, expenses and taxes. Prior to June 2020, the objective and strategic asset allocation of fund were materially different. From 1 July these were amended to include equities.

Asset Allocation



Top 5 Fixed Income Issuers*	(%)
NZ Local Govt Funding Agency	5.09
Westpac Banking Corp	4.77
Bank of New Zealand	4.44
Kiwibank Ltd	3.62
GMT Bond Issuer Ltd	3.22

Duration*
Fund 4.64 years
Yield to Maturity
Fund (gross) 2.83%

Top 10 Equities	(%)		(%)
Heartland Group	3.54	Contact Energy Ltd	2.17
Skellerup Ltd	3.19	Works Finance NZ	1.97
Stride Stapled Group	2.88	Scales Corp Ltd	1.95
Spark Ltd	2.62	Argosy Property Ltd	1.86
Infratil Ltd	2.60	Mercury Energy Ltd	1.67

*Includes cash holdings.

Fund Commentary

Third quarter GDP came in at -3.7% versus expectations of -4.1%, the fall reflecting impact of the recent Auckland lockdown. Pre-pandemic this would a been considered a monster of a GDP fall, but lessons from past lockdowns suggest that economic activity will pick up where it left off as lockdown restrictions are lifted. The Reserve Bank will likely consider GDP as interesting in that it is better than their November MPS forecast of -7.0%, however given it's impacted by a lockdown and that prior lockdowns have seen consumption bouncing back once restrictions are lifted it provides little new insight into appropriate monetary policy settings. This leaves us with much the same view regarding the economy and investment markets in 2022. In summary:

(1) Monetary conditions will continue to tighten at a measured pace.
(2) The labour market is strong with low unemployment and capacity constraints, this is likely to continue until boarder restrictions are reduced or demand abates.
(3) Supply chains are challenged but unlikely to further deteriorate.
(4) Inflation will remain well above the Reserve Bank's 1-3% band in the first half of 2022, however, should ease thereafter as both the base effect of prior high inflation numbers roll out and the impact of increased interest rates dampens consumption.
(5) The world is awash with debt, smaller interest rate increases will be required than in the past to slow demand.
(6) Vaccinations rates continue to rise, and the risk of severe lockdowns is diminishing as we move to a COVID endemic world with the introduction of the Governments traffic light system.

This sees us expecting continued Official Cash Rate (OCR) increases with risks surrounding the OCR peaking at a lower level than many assume and possibly take longer than expected to get there. This should be a positive outcome for all interest sensitive investment sectors. Even though we believe longer term bond rates are near their peak, over the past few months the fund has held higher levels of cash than it would normally do so to help mitigate the impact of rising interest rates.

The fund's exposure to the alternative investment sector via the Option Fund has also provided a source of returns and diversity as investment outcomes and characteristics from this sector are not highly correlated with traditional equity and bond assets. The fund is also holding close to the upper permitted limit of shares as we continue to believe shares have a good chance of outperforming bonds over the next three years. As noted in previous commentaries, the market is pricing in around a further 2% of OCR rises by the Reserve Bank. With this in mind we think we need to see further unexpected rises in inflation or economic growth rates for interest rates to push much higher as current pricing already reflects increased inflation uncertainty and Central Banks' removal of economic stimulus. With interest rates likely to remain low relative to historical levels we continue to believe it is appropriate for investors to seek income from more diverse sources than the interest rate market alone. Even though some equity prices have fallen we believe the environment remains attractive for equities, even though catalysts for new growth remain elusive. This means the Income Fund will remain invested in a range of NZ companies listed on the NZX that pay an acceptable level of dividends or who have the likelihood of doing so in the future. In addition to the fund receiving a steady stream of dividend income, we expect that over time the industry sectors and business models adopted by these companies should be rewarded by a steady or rising share price. The bond sector of the fund is invested primarily in medium to longer duration assets balanced out with a higher than usual allocation to cash. We are happy to have exposure to longer term assets as even though the OCR will rise, much of the anticipated increases are already reflected in market pricing and the OCR peak is likely to be low compared to previous tightening cycles. Once again, the month of December demonstrated that investing in a diversified portfolio of income focused assets provides some protection from the downturn in individual holdings or asset classes.

Key Fund Facts

Distributions
Distributions for this fund are defined annually and are effective for the calendar year. The defined rate is gross of tax. Distributions are not a taxable event. Tax will be deducted (refunded) at 31 March and on full or partial withdrawals.

Estimated annual fund charges (incl. GST)
0.80%, refer PDS for more details

Hedging
All investments will be in New Zealand dollars

Buy / Sell spread:
Click to view

Strategy size
$5.3m

Strategy Launch
October 2007

Restrictions
Adult entertainment, gambling, fossil fuels, alcohol stocks, tobacco stocks. For more information please refer to the Statement of Investment Policy and Objectives (SIPO) which can be found on our website https://www.nikkoam.co.nz/invest/retail.

Exclusions
Securities that conduct activities listed on the Schedule to Cluster Munitions Prohibition Act 2009. Tobacco manufacturers.

Compliance

The fund complied with its investment mandate and trust deed during the quarter.

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